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Revised 2020 Outlook

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JHH Wealth, LLC.

March 24, 2020 Letter to Clients

RECAP – What Just Happened?

After an unusually profitable 2019 the market became overvalued.[1] As 2019 ended, this state of overvaluation entered a year with several unique considerations. At the start of 2020 the bull market was at record lengths, election years tend to be volatile, and the Coronavirus pandemic was beginning. JHH believed any combination of these considerations could be the catalyst that begins a recession many analysts believed to be long overdue.

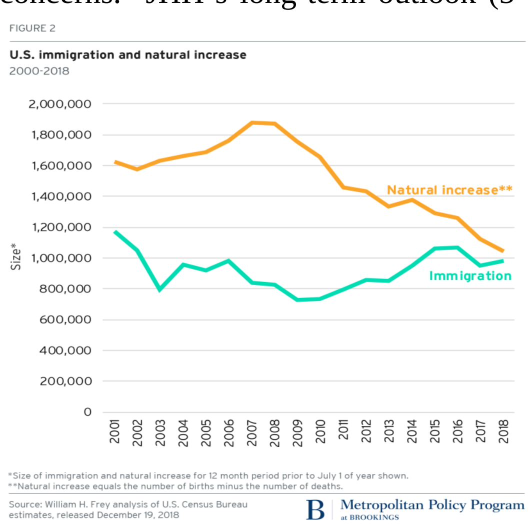
This market environment led JHH to reduce risk in model portfolios on February 1st. Precedent shows that recessions/bear markets materialize over several months or even years.[2] JHH's 2020 outlook detailed the plan to further reduce risk, or conversely, return risk to previous levels as the considerations materialized throughout the year.

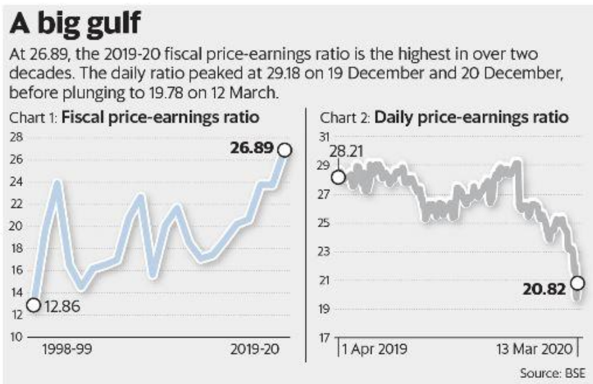
Fast forward to today. The rapid drop into bear market territory has been unprecedented. The S&P 500 is down 34% from its recent February all-time highs. Even a month ago, no one could have predicted the pace and extent of this sell-off. Although news remains heavily tilted towards 'glass half empty' surrounding the potential economic impact of the Coronavirus, indicators and fundamentals are showing that many segments of the markets are now undervalued due to indiscriminate selling.[3]

Revising Our Outlook

JHH entered 2020 with several short-term concerns. JHH's long-term outlook (5 to 7 years) was also dampened relative to average returns due to negative trends in three key factors that contribute to equity growth:

- Population Growth – population growth has slowed to century low levels.[4] Simply put, less workers leads to reduced GDP growth.

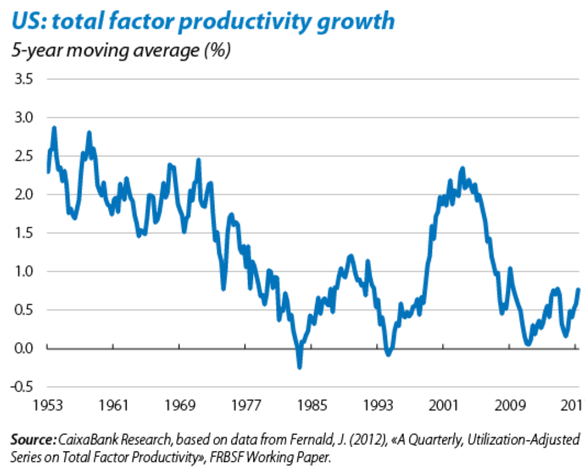




Graphic by Paras Jain/Mint

- Price-to-Earnings Ratio Expansion – prior to the current selloff, P/E ratios on trailing 12-month earnings were hitting 20-year highs.[5] Expecting P/E's to continue upwards on a trajectory that can sustain recent equity outperformance (relative to average equity performance) became unreasonable.

- Productivity Growth – utilizing more efficient use of labor per unit of output. Higher productivity leads to higher wages and company profits. Productivity growth has been on a steady decline.[6]



The stock market has historically returned an average of 10% annually.[7] The above factors led to JHH's conclusion that the equity market had the potential to produce of 6-7% annual returns over the next 5-7 years, well below that 10% average that equity investors have come to expect. JHH's long term outlook has changed due to the rapid selloff.

The recent selloff has resulted in valuation levels toward the lower end of modern market history. P/E ratios on trailing earnings have fallen to 14.45 from their recent highs of 22.77.[8] Even when still factoring in further declines in population and productivity rates, the drop in P/E is conducive to a 5-7-year average annual return of 12-14%. Earnings will most likely have severe short-term disintegration due to the Coronavirus. However, with a 34% drop in the S&P500 before the true severity of earnings deterioration has revealed itself, one must question how much disintegration is already 'priced in'.

Furthermore, the prudent investor should look out to further time horizons when attempting to identify value. While JHH does expect earnings disintegration, we predict the planned massive stimulus package will take hold in 3 to 4 quarters, driving growth and earnings to solid recovery levels. At current P/E levels, the average company can have an earnings recovery period of 2-3 years. If earnings then rise above those recovery levels in 4-6 years, the average company will not only fully recover the loss experienced during this rapid decline but also see 25% earnings growth in future years. 25% equals 3-4% compounded annually per year over the next 5-7 years. This translates to a 5-7-year average annual return of 12-14% going forward.

Conclusion

The selloff has been swift and severe. Since de-risking on February 1st, JHH has until now resisted the impulse to 'buy the dips.' Due to the rapid and unprecedented selloff, JHH is revising our market outlook published in early February. Our opinion is that the potential return for equity holdings has doubled from where the markets were not even 60 days ago.

JHH's philosophy is that timing the market is impossible and a fool's errand.[9] This certainly may not be the bottom and we understand the anxiety and fear associated with the potential of further declines. However, evidence shows that entering the markets, or adding on risk, at these levels has the potential to reward investors with above-average returns over the next 5 to 7 years.

For those who have until now weathered the storm in buy-and-hold strategies, historical precedence shows that resilience will be rewarded with extended periods of growth following this decline.

In the chart above, the green time periods indicate bull markets, when the S&P 500 rose 20% or more from its previous low. The red time periods indicate bear markets, when the S&P 500 declined 20% or more from its previous high.

The bold numbers calculate the duration of months for the market either being bull or bear and the percentages cover the total return for the time period. On average when the market is evaluated from 1956-2017, there were bear markets or losses for 12.2 months while the bull markets or gains was for 54.8 months.

1 Source: Bloomberg L.P. Returns from Aug. 2, 1956 - Dec. 31, 2017. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap US stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. This chart is for illustrative purposes only and not indicative of any actual investment. These returns were the result of certain market factors and events which may not be repeated in the future. *Past performance is no guarantee of future results.*

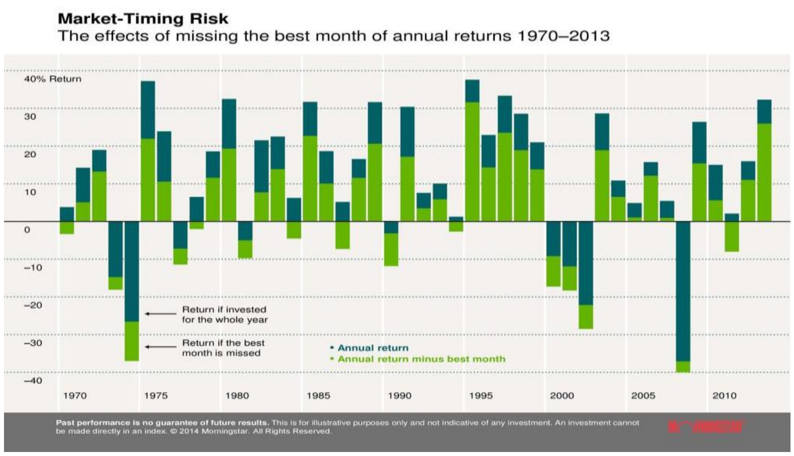
2 Source: Invesco

Warren Buffet famously said that "Wall Street makes its money on activity; you make your money on inactivity." As visualized in the chart above, downturns such as the one we are experiencing now tend to be short-lived relative to the period of growth that follows. **Hang in there!**

For those who have de-risked and/or have cash on the sideline, understand that JHH's philosophy is timing the market is impossible and a fool's errand. This certainly may not be the bottom and we understand the anxiety and fear associated with the potential of further declines. However, we once again defer to a famous quote by Mr. Buffet: "Don't pass up something that's attractive today because you think you will find something better tomorrow."

Simply put, the markets are very attractive at current valuations. Historical precedence has shown that those who do not heed Mr. Buffet's advice may miss out on substantial portions of subsequent rallies.

Recoveries can be swift. The chart to the right visualizes how annual returns can be impacted by missing out on the best months, and the best months and days tend to happen very close to the worth months and days. In fact, during the 20-year period between Jan. 1, 1999, to Dec. 31, 2018, if you missed the top 10 best days in the stock market, your overall return was cut in half.[10]



To ALL investors: It has been quite the ride. Stay positive, and we'll see you on the other side.

Sincerely, your JHH team:

Jeff Hines, CFA®
Portfolio Manager

Eric Hines, MSF
Portfolio Manager

David Jackson III
Analyst

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